

### § 1.535-3

### 26 CFR Ch. I (4-1-03 Edition)

in the case of bank affiliates (as defined in section 2 of the Banking Act of 1933; 12 U. S. C. 221a(c)).

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6805, 30 FR 3209, Mar. 9, 1965; T.D. 6841, 30 FR 9305, July 27, 1965; T.D. 7301, 39 FR 964, Jan. 4, 1974; T.D. 7649, 44 FR 60086, Oct. 18, 1979]

#### § 1.535-3 Accumulated earnings credit.

(a) *In general.* As provided in section 535(a) and § 1.535-1, the accumulated earnings credit, provided by section 535(c), reduces taxable income in computing accumulated taxable income. In the case of a corporation, not a mere holding or investment company, the accumulated earnings credit is determined as provided in paragraph (b) of this section and, in the case of a holding or investment company, as provided in paragraph (c) of this section.

(b) *Corporation which is not a mere holding or investment company—(1) General rule.* (i) In the case of a corporation, not a mere holding or investment company, the accumulated earnings credit is the amount equal to such part of the earnings and profits of the taxable year which is retained for the reasonable needs of the business, minus the deduction allowed by section 535(b)(6) (see paragraph (f) of § 1.535-2, relating to the deduction for long-term capital gains). In no event shall the accumulated earnings credit be less than the minimum credit provided for in section 535(c)(2) and subparagraph (2) of this paragraph. The amount of the earnings and profits for the taxable year retained is the amount by which the earnings and profits for the taxable year exceed the dividends paid deduction for such taxable year. See section 561 and §§ 1.561-1 and 1.561-2, relating to the deduction for dividends paid.

(ii) In determining whether any amount of the earnings and profits of the taxable year has been retained for the reasonable needs of the business, the accumulated earnings and profits of prior years will be taken into consideration. Thus, for example, if such accumulated earnings and profits of prior years are sufficient for the reasonable needs of the business, then any earnings and profits of the current taxable year which are retained will not be considered to be retained for the rea-

sonable needs of the business. See section 537 and §§ 1.537-1 and 1.537-2.

(2) *Minimum credit.* Section 535(c)(2) provides for the allowance of a minimum accumulated earnings credit in the case of a corporation which is not a mere holding or investment company. Except as otherwise provided in section 243(b)(3) and § 1.243-5 (relating to effect of 100-percent dividends received deduction under section 243(b)) and sections 1561, 1562, and 1564 (relating to limitations on certain tax benefits in the case of certain controlled corporations), in the case of such a corporation, this minimum credit shall in no case be less than the amount by which \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975) exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year. See paragraph (d) of this section for the effect of dividends paid after the close of the taxable year in determining accumulated earnings and profits at the close of the preceding taxable year. In determining the amount of the minimum credit allowable under section 535(c)(2), the needs of the business are not taken into consideration. If the taxpayer has accumulated earnings and profits at the close of the preceding taxable year equal to or in excess of \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975), the credit, if any, is determined without regard to section 535(c)(2). It is not intended that the provision for the minimum credit shall in any way create an inference that an accumulation in excess of \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975) is unreasonable. The reasonable needs of the business may require the accumulation of more or less than \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975), depending upon the circumstances in the case, but such needs shall not be taken into consideration to any extent in cases where the minimum accumulated earnings credit is applicable. For a discussion of the reasonable needs of the business, see section 537 and §§ 1.537-1, 1.537-2, and 1.537-3.

(3) *Illustrations of accumulated earnings credit.* The computation of the accumulated earnings credit provided by

section 535(c) may be illustrated by the following examples:

*Example 1.* The X Corporation, which is not a mere holding or investment company, has accumulated earnings and profits in the amount of \$125,000 as of December 31, 1974. Thus, the minimum credit provided by section 535(c)(2) exceeds the accumulated earnings and profits of X by \$25,000. It has earnings and profits for the taxable year ended December 31, 1975, in the amount of \$100,000 and has a dividends paid deduction under section 561 in the amount of \$30,000 so that the earnings and profits for the taxable year which are retained in the business amount to \$70,000. Assume that it has been determined that the earnings and profits for the taxable year which may be retained for the reasonable needs of the business amount to \$55,000 and that a deduction has been allowed under section 535(b)(6) in the amount of \$5,000. Since the amount by which \$150,000 exceeds the accumulated earnings and profits at the close of the preceding taxable year is less than \$50,000 (\$55,000-\$5,000), the minimum credit provided by section 535(c)(2) will not apply and the accumulated earnings credit must be computed under section 535(c)(1) on the basis of the reasonable needs of the business. In this case, the accumulated earnings credit for the taxable year ended December 31, 1975, will be \$50,000 computed as follows:

Earnings and profits of the taxable year determined to be retained for the reasonable needs of the business .....	\$55,000
Less: The deduction for long-term capital gains (less applicable tax) allowed under sec. 535(b)(6) .....	5,000
Accumulated earnings credit allowable under sec. 535(c)(1) .....	50,000

*Example 2.* The Z Corporation which is not a mere holding or investment company, has accumulated earnings and profits in the amount of \$45,000 as of December 31, 1974; it has earnings and profits for the taxable year ended December 31, 1975, in the amount of \$115,000 and has a dividends paid deduction under section 561 in the amount of \$10,000, so that the earnings and profits for the taxable year which are retained amount to \$105,000. Assume that it has been determined that the accumulated earnings and profits of the taxable year which may be retained for the reasonable needs of the business amount to \$20,000 and that no deduction is allowable for long-term capital gains under section 535(b)(6). The accumulated earnings credit allowable under section 535(c)(1) on the basis of the reasonable needs of the business is determined to be only \$20,000. However, since the amount by which \$150,000 exceeds the accumulated earnings and profits at the close of the preceding taxable year is more than \$20,000, the minimum accumulated earnings credit provided by section 535(c)(2) is applica-

ble. The allowable credit will be the amount by which \$150,000 exceeds the accumulated earnings and profits at the close of the preceding taxable year (*i.e.*, \$105,000, \$150,000 less \$45,000 of accumulated earnings and profits at the close of the preceding taxable year).

(c) *Holding and investment companies.* Section 535(c)(3) provides that, in the case of a mere holding or investment company, the accumulated earnings credit shall be the amount, if any, by which \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975) exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year. Thus, if such a corporation has accumulated earnings equal to or in excess of \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975) at the close of its preceding taxable year, no accumulated earnings credit is allowable in computing the accumulated taxable income. See paragraph (c) of § 1.533-1 for a definition of a holding or investment company. For the accumulated earnings credit of a mere holding or investment company which is a member of an affiliated group which has elected the 100-percent dividends received deduction under section 243(b), see section 243(b)(3) and § 1.243-5. For the accumulated earnings credit of a mere holding or investment company which is a component member of a controlled group of corporations (as defined in section 1563), see sections 1561, 1562, and 1564.

(Sec. 1561(a) (83 Stat. 599; 26 U.S.C. 1561(a)))

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#### § 1.536-1 Short taxable years.

Accumulated taxable income for a taxable year consisting of a period of less than 12 months shall not be placed on an annual basis for the purpose of the accumulated earnings tax imposed by section 531. In such cases accumulated taxable income shall be computed on the basis of the taxable income for such period of less than 12 months, adjusted in the manner provided by section 535(b) and § 1.535-2.